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No. 09-174

Supreme Court, U.S.
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In The

Supreme Court of the United States

ANDREW D. GLOGOWER,

Petitioner,

v.

SHARON P. CLARK, Liquidator of National Business Association Trust and National Benefit Administrators,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Should this Court review the Court of Appeals for the Ninth Circuit's holding that collateral estoppel principles and public policy reasons required full faith and credit be given to the Kentucky state court's judgment that the National Business Association, Inc. ("NBA") was part of the same legal entity as the National Business Association Trust ("NBAT"), an express trust, for purposes of determining whether a judgment against the debtor for taking improper transfers from NBA was non-dischargeable under 11 U.S.C. § 523(a)(4) as a debt "for fraud or defalcation while acting in a fiduciary capacity," where nothing in the Bankruptcy Code conflicts with or precludes the Kentucky court's determination as to what property was included in the *res* of the NBAT express trust?

2. Should this Court resolve a matter of first impression, whether a fiduciary under ERISA fulfills the requirements of a fiduciary under 11 U.S.C. § 523(a)(4)?

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OPINION BELOW

The decision of the Ninth Circuit Court of Appeals is not reported, but the unpublished memorandum disposition dated April 3, 2009 is available on Westlaw at 2009 WL 887959. The Order denying the Petition for Rehearing and the Petition for Rehearing En Banc dated May 11, 2009, and the decisions of the District Court and the Bankruptcy Court are not reported. Copies of all four decisions are reproduced in the Appendix. (See Petitioner's App. A).

STATEMENT OF JURISDICTION

The judgment of the U.S. Court of Appeals for the Ninth Circuit was entered on April 3, 2009. The Petitioner timely filed a Petition for Rehearing/Rehearing En Banc on April 15, 2009. The Petition for Rehearing was denied on May 11, 2009. Petitioner filed a Writ of Certiorari on August 7, 2009. Petitioner invokes the jurisdiction of the United States Supreme Court under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The McCarran-Ferguson Act, 15 U.S.C. § 1012, states, "[t]he business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business. . . . No Act of Congress shall be construed to invalidate, impair, or supersede

any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance." (App. A).

The United States Bankruptcy Code, 11 U.S.C. § 109 provides that a person will not be a debtor under Chapter 7 if they are "a domestic insurance company. . . ." (App. A).

The United States Bankruptcy Code, 11 U.S.C. § 727 provides, as to a debtor under Chapter 7, that, except in circumstances enumerated in that section and except as to certain categories of debts excepted from discharge under 11 U.S.C. § 523(a), "[t]he court shall grant the debtor a discharge." (Petitioner's App. E).

11 U.S.C. § 523(a)(4) excepts from dischargeability any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." *Id.* (Petitioner's App. E).

Article I, Section 8, Clause 4 of the U.S. Constitution provides for the power of Congress: "To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." *Id.* (Petitioner's App. E).

28 U.S.C. § 1738 sets forth the manner in which Congress declared that full faith and credit is to be given in stating that "[t]he . . . judicial proceedings of any court of any . . . State, Territory or Possession . . .

shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken." (App. A).

29 U.S.C. § 1002(21)(a) of the Employment Retirement Income Security Act ("ERISA") holds that "a person is a fiduciary with respect to an ERISA plan if: (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, . . . or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan." (App. A).

29 U.S.C. § 1104(a)(1) of ERISA provides that a controlling fiduciary " . . . shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries. . . ." (App. A).

KRS § 304.33-010(4)(g) of the Kentucky Insurers Rehabilitation and Liquidation Law expressly provide that " . . . proceedings in cases of insurer insolvency and delinquency shall be deemed an integral aspect of the business of insurance and are of vital public interest and concern." (App. A).

KRS § 304.11-030(3)(b) of the Kentucky Insurers Rehabilitation and Liquidation Law provides that "in event of failure of any such unauthorized insurer to pay any claim . . . , any person who assisted or in any manner aided directly or indirectly in the

procurement of such insurance contract shall be liable to the insured for the full amount of the claim. . . ." (App. A).

KRS § 304.33-140 of the Kentucky Insurers Rehabilitation and Liquidation Law sets forth the grounds upon which the Kentucky Commissioner of Insurance may seek the liquidation of an insurer, including " . . . that [she] has reasonable cause to believe that there has been . . . wrongful sequestration or diversion of the insurer's assets . . . that if established would endanger assets in an amount threatening the solvency of the insurer . . . ; . . . that the insurer is or is about to become insolvent . . . ; [and] that the insurer is in such condition that the further transaction of business would be hazardous, financially or otherwise, to its policyholders, its creditors, or the public. . . ." (App. A).

KRS § 304.33-190 of the Kentucky Insurers Rehabilitation and Liquidation Law provides that the Franklin Circuit Court " . . . shall have exclusive jurisdiction over all matters relating to the [insurer] liquidation, including, but not limited to, the proper scope and application of the provisions of this subtitle to the liquidation as well as all interpretation and enforceability of all contracts of insurance to which the insurer is a party." (App. A).

KRS § 304.33-240 of the Kentucky Insurers Rehabilitation and Liquidation Law provides a Liquidator with express authority to " . . . prosecute any action which may exist in behalf of the creditors,

members, policyholders, or shareholders of the insurer against any officer of the insurer, or any other person. . . ." (App. A).

STATEMENT OF THE CASE

In 1987, the National Business Association Trust ("NBAT") was organized for the purpose of providing health insurance coverage to their employees. (E.R. 1).[1] At its peak, NBAT provided insurance coverage to employees in twenty-one (21) states.[2] (E.R. 12). Despite a significant presence within the Kentucky insurance industry, however, NBAT never requested nor received a certificate of authority from the Kentucky Department of Insurance to transact insurance business in the Commonwealth. As such, NBAT was operating as an unauthorized insurer in the Commonwealth. (E.R. 113).

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[1] "E.R." shall mean the Excerpts of Record Volume 1 and Volume 2 filed by the Liquidator of the National Business Association Trust/National Benefit Administrators with the United States Court of Appeals for the Ninth Circuit, January 25, 2008.

[2] In addition to Kentucky, NBAT conducted unauthorized insurance business in the following states: Alabama, Arkansas, Colorado, Florida, Georgia, Illinois, Indiana, Louisiana, Missouri, Mississippi, North Carolina, New Mexico, New York, Ohio, Pennsylvania, South Carolina, Tennessee, Texas, Virginia, and West Virginia.

As is a common practice in the creation of unauthorized insurers, at its inception in 1987, NBAT entered into an Administration Agreement with National Business Association, Inc. ("NBA"). (E.R. 13). Under the Administration Agreement, NBA was responsible for every aspect of NBAT's operations, including: marketing, underwriting, collection of premiums, claims adjustment, and claims settlement. (E.R. 120 at 122-23). In return, under the Administrative Agreement, NBAT agreed to pay NBA twenty percent (20%) of all "contributions" (i.e., premiums) to the trust as an "administrative fee." (E.R. 13 at 17).

As noted by the United States Bankruptcy Court, District of Arizona ("Bankruptcy Court"), "[t]he operations of NBAT were a financial disaster in every sense of the word." (E.R. 229 at 230). Instead of implementing the sound actuarial practices required by the Kentucky Insurance Code (including the establishment of sufficient reserves), NBA administered the Trust on a strictly cash flow basis, paying claims from new revenues. (E.R. 202-203). Accordingly, by May 1990, less than three (3) years following its creation, NBAT ceased doing business – resulting in *millions* of dollars in outstanding benefits claims and little recourse for its thousands of policyholders. (E.R. 229 at 231).

On July 27, 1990, the Kentucky Department of Insurance filed a petition in the Commonwealth of Kentucky, Franklin Circuit Court ("Franklin Circuit Court") seeking liquidation of NBAT and NBA. (E.R. 102). The action alleged that: (1) NBAT was operating

as an unauthorized insurer; (2) NBAT was or was about to become insolvent; and (3) assets were wrongfully diverted from NBAT to NBA. *Id.* On June 20, 1991, the Franklin Circuit Court held that NBAT was an unauthorized insurer doing business in Kentucky and consequently placed NBAT into liquidation. (E.R. 113). The Commissioner of the Kentucky Department of Insurance was named as the Liquidator ("Liquidator").

During the state court liquidation proceedings, the Liquidator sought liquidation of NBA as well as NBAT on the grounds that there was no legal distinction between NBA and NBAT. The Liquidator contended that NBA and NBAT failed to follow the formalities of separate corporate existence, such that there should be no legal distinction between the two. The Franklin Circuit Court granted the Liquidator summary judgment, and entered an order holding that NBA and NBAT were a single entity and placed NBA under liquidation pursuant to the June 20, 1991 liquidation order. (E.R. 120). Because NBAT and NBA have been found as a matter of law to be one entity, they will be referred to hereinafter as NBAT/NBA Express Trust.

On reviewing the insolvent insurer's financial information, the Liquidator concluded that NBA's former President and CEO, Andrew D. Glogower ("Glogower" and/or "Petitioner"), had failed to properly account for NBAT/NBA Express Trust funds (over which he had complete control and authority). Several transactions were found to be of particular

concern. Specifically, in June 1989, while acting as a director of the administrative component of the express trust, Glogower approved a resolution authorizing a Bonus Payment in the amount of $362,282.70 from NBA to himself. (E.R. 178 at 181). Additionally, in September, 1988, while acting as director of NBA, Glogower approved a resolution authorizing the execution of a promissory note in the amount of $495,297.30 from NBA to himself. *Id.* Loan Payments were made to Glogower in partial satisfaction of the promissory note on November 6, 1989, November 8, 1989, December 5, 1989, and April 26, 1989, in the total amount of $395,000.00. *Id.*

On March 10, 1992, the Liquidator filed a civil action in the Commonwealth of Kentucky, Franklin Circuit Court against the Petitioner, as well as other officers and directors of the NBAT/NBA Express Trust, and on February 10, 1998, filed an Amended Complaint. (E.R. 127). On August 31, 1999, the Franklin Circuit Court entered a judgment in favor of the Liquidator against Glogower. (E.R. 161). The Judgment, *inter alia*, held Glogower liable for $395,000.00 for the unauthorized Loan and Bonus Payments he had received. *Id.*

When the Liquidator attempted to collect on the aforementioned judgment, the Petitioner declared bankruptcy in Arizona. The Liquidator filed an action before the Bankruptcy Court to designate the Franklin Circuit Court's Judgment non-dischargeable in the bankruptcy proceeding pursuant under 11 U.S.C. § 523(a)(4), which provides an exception to

dischargeability for debts "for fraud or defalcation while acting in a fiduciary capacity. . . ." (E.R. 167).

On September 17, 2003, the Bankruptcy Court issued its decision, finding that the June 1989 Bonus Payment of $362,282.70 and the Loan Payments paid between November 1989 and April 1990, totaling $395,000.00 constituted defalcation, and therefore, were non-dischargeable under 11 U.S.C. § 523(a)(4). (E.R. 229). The Bankruptcy Court noted that "Glogower's actions were particularly egregious where NBAT/NBA was holding properly payable benefit checks due plan participants/employees because there were insufficient funds to allow such checks to be honored when presented." *Id.* at 232. The Bankruptcy Court, however, did not hold Glogower's liability for the unpaid claims non-dischargeable, concluding that KRS § 304.11-030(1)'s provisions regarding unauthorized insurers did not constitute an exception to dischargeability under 11 U.S.C. § 523. *Id.* at 233. Glogower then appealed the Bankruptcy Court's ruling to the United States District Court for the District of Arizona ("District Court").

On May 31, 2007, the District Court reversed the Bankruptcy Court's ruling and held that the $362,282.70 Bonus Payment and the Loan Payments of $395,000.00 (as well as the pre- and post-judgment thereon) were dischargeable under 11 U.S.C. § 523(a)(4). (E.R. 259). The District Court held that the application of 11 U.S.C. § 523(a)(4) depended on the existence of an express or technical trust with respect to the funds in question. Notwithstanding the

fact that NBAT was an express trust and the Kentucky state court had already held NBAT and NBA were one legal entity, the District Court concluded that with respect to the funds transferred from NBA, "the Liquidator failed to meet its burden of establishing the existence of an express trust, and the Bankruptcy Court therefore erred in denying the Debtor a discharge under § 523(a)(4) with respect to the Bonus and Loan Payments." *Id.* at 270. On June 28, 2007, the Liquidator filed a timely Notice of Appeal to have the Ninth Circuit Court of Appeals review the District Court's May 31, 2007 Order. (E.R. 274).

The Ninth Circuit Court of Appeals reversed the District Court. The court acknowledged that under circuit precedent, for 11 U.S.C. § 523(a)(4) to apply, "the fiduciary relationship must be one arising from an express or technical trust that was imposed before and without reference to the wrongdoing that caused the debt." *Clark v. Glogower*, No. 07-16188, 2009 WL 887959, 811 (9th Cir. Apr. 03, 2009) (quoting *In re Lewis*, 97 F.3d 1182, 1185 (9th Cir. 1996)). The court held that the requirement of an express trust as to the assets of NBA was satisfied because it owed full faith and credit to the Franklin Circuit Court's determination that NBAT and NBA were a single entity. *Id.* at 812. Additionally, the court held that the fact that Glogower was a fiduciary under ERISA fulfilled the requirements of a fiduciary duty for purposes of 11 U.S.C. § 523(a)(4). *Id.* at 811. Finally, the Ninth Circuit Court held the Loan Payments and Bonus

Payments did constitute a defalcation under 11 U.S.C. § 523(a)(4). *Id.* at 812.

ARGUMENT

The Petitioner miscasts the issue before this Court as whether an "express" or "technical" trust must be shown for 11 U.S.C. § 523(a)(4)'s dischargeability exception to apply. As the Petitioner somewhat grudgingly acknowledges, however, the Ninth Circuit did expressly state that for liability to be imposed under 11 U.S.C. § 523(a)(4), the liability must be one arising from an express or technical trust that was imposed before and without reference to the wrongdoing giving rise to the claim. *See* Petition at 10. Thus, the Ninth Circuit did apply the narrow view of § 523(a)(4) that the Petitioner advocates.

The actual issue raised by the Petition, therefore, concerns the Petitioner's objection to the Ninth Circuit's conclusions that it was required to give full faith and credit to the Franklin Circuit Court's determination that NBA and NBAT were a single entity, and that this determination satisfied the Ninth Circuit's express or technical trust requirement. The Petitioner incorrectly contends that in giving effect to this state-court determination, the Ninth Circuit improperly elevated state insurance law over federal bankruptcy law in violation of the Bankruptcy Uniformity and Supremacy Clauses of the United States Constitution. That is not the case.

Granting full faith and credit to the Franklin Circuit Court's determination that NBA and NBAT were one and the same legal entity does not in any way conflict with federal bankruptcy law. To the contrary, this Court's precedents require that federal bankruptcy courts recognize the collateral estoppel effect of state court determinations on issues relating to the elements of a non-dischargeability claim. *See Grogan v. Garner*, 498 U.S. 279 (1991). The Franklin Circuit Court's ruling was not inconsistent with federal bankruptcy law. Even under the narrow view of 11 U.S.C. § 523(a)(4) advocated by the Petitioner, federal law merely imposes the requirement that the funds in question be subject to an express or technical trust. Nothing in the Bankruptcy Code purports to preempt the application of state law concerning what assets are included in the *res* of an express or technical trust, or whether a legal entity claiming to be separate from an express trust has so utterly failed to adhere to corporate formalities that it may be deemed to be the same legal entity as the express trust.

The importance of giving full faith and credit to the Franklin Circuit Court's judgment is reinforced by the express federal policy recognizing the primacy of state regulation of the insurance industry where not specifically and expressly preempted, even in the context of bankruptcy proceedings. The McCarran-Ferguson Act provides that federal laws will not supersede state insurance law, unless the federal law "specifically relates to the business of insurance." 15

U.S.C. § 1012. Federal deference to state insurance regulation is also expressly recognized in the Bankruptcy Code, 11 U.S.C. § 109(b)(2), which states that a domestic insurance company may not be a debtor under Chapter 7. This federal policy weighs heavily in favor of granting deference to state court determinations concerning the validity of efforts by an insurer to circumvent insurance regulation and its fiduciary duties by sequestering assets from a state-regulated insurer into a purportedly separate legal entity.

In addition to reaffirming the need to give full faith and credit to state court determinations in non-dischargement proceedings, this case offers the Court an opportunity to affirm the Ninth Circuit's precedents holding that a debtor's status as a fiduciary under ERISA satisfies the fiduciary duty element of 11 U.S.C. § 523(a)(4). This is an issue of first impression for the Court, and a definitive ruling from this Court on the question would provide valuable guidance to the lower federal courts in applying § 523(a)(4). ERISA expressly provides that "a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plant or exercises any authority or control respecting management or disposition of its assets. . . ." 29 U.S.C. § 1002(21)(A). This provision expresses an important federal policy imposing strict duties on persons such as Glogower to administer ERISA benefit plan funds in the best interest of the plan

beneficiaries. The Ninth Circuit has correctly determined that these duties are precisely the kind of duties that are intended to be non-dischargeable under § 523(a)(4). This Court should affirm that precedent.

I. THE NINTH CIRCUIT COURT OF APPEALS WAS REQUIRED TO GIVE FULL FAITH AND CREDIT TO THE FRANKLIN CIRCUIT COURT'S 1995 ORDER, AND THEREFORE, HOLD THE BONUS PAYMENT AND LOAN PAYMENT NON-DISCHARGEABLE PURSUANT TO 11 U.S.C. § 523(A)(4).

The Ninth Circuit Court of Appeals' decision does not permit Kentucky state insurance regulations to override established federal bankruptcy law in violation of the bankruptcy uniformity clause of the U.S. Constitution. In order to find a debt non-dischargeable due to defalcation under 11 U.S.C. § 523(a)(4), the following elements must be proven: (1) the existence of a fiduciary relationship; (2) that this fiduciary relationship turned on the existence of an express or technical trust that placed a specific *res* in the hands of the debtor; and (3) that the debtor misappropriated or failed to account for those trust funds. *See R.E. America, Inc. v. Garver (In re Garver)*, 116 F.3d 176, 178-179 (6th Cir. 1997); *see also Commonwealth Land Title Co. v. Blaszak (In re Blaszak)*, 397 F.3d 386, 390-391 (6th Cir. 2005); *In re Cantrell*, 329 F.3d 1119, 1125 (9th Cir. 2003) (*quoting*

Lewis v. Scott (In re Lewis), 97 F.3d 1182, 1185 (9th Cir. 1996) ("The fiduciary relationship must be one arising from an express or technical trust that was imposed before and without reference to the wrongdoing that caused the debt."). In the matter at hand, the Ninth Circuit stated it owed full faith and credit to the Franklin Circuit Court's factual determination that NBAT and NBA were one and the same entity, and therefore, held the Liquidator had satisfied its burden of establishing an express trust. *Clark v. Glogower*, No. 07-16188, 2009 WL 887959, 812 (9th Cir. Apr. 03, 2009). The Petitioner does not question that NBAT itself was an express or technical trust.

The Ninth Circuit's decision reflects the proper application of principles of full faith and credit and collateral estoppel in bankruptcy proceedings. Indeed, Petitioner himself concedes that "it is generally true that a judgment by a court of competent jurisdiction bears a presumption of regularity and is not thereafter subject to collateral attack," provided that the state judgment does not "conflict[ ] with federal bankruptcy law." *See* Petition at 30. There is no conflict between the Kentucky state court judgment and federal bankruptcy law. The state court determined that there was no legally valid separation between the funds of NBA and those of NBAT, which were indisputably impressed with an express or technical trust. Petitioner identifies no federal law that would contradict this determination. The Franklin Circuit Court's judgment did not purport to alter the elements required to prove non-dischargeability under

11 U.S.C. § 523(a)(4). It merely conclusively determined one element of the test prescribed by federal law (as interpreted by the Ninth Circuit) – i.e., the existence of an express or technical trust with respect to the funds in question.

The Petitioner would have the Court hold that the bankruptcy uniformity clause of the U.S. Constitution precludes federal bankruptcy courts from giving any weight to state-court determinations on factual or legal issues relevant to non-dischargeability claims, whether or not those determinations are consistent with federal law. Such a rule is inconsistent with this Court's precedents and with the strong federal policy of deferring to the states on matters of insurance regulation. This Court should decline the Petitioner's invitation and instead use this case as an opportunity to reaffirm the importance of giving comity to state courts in federal bankruptcy proceedings, particularly in the sphere of insurance regulation.

A. Collateral Estoppel Principles Apply in Discharge Exception Proceedings.

The Kentucky Insurers Rehabilitation and Liquidation Law, KRS Chapter 304.33, unequivocally provides the Liquidator with specific statutory authority to exercise and enforce the remedies of creditors, members, policyholders, or shareholders of an insolvent insurer and to protect the interests of the general public. KRS § 304.33-010. In the state

court case, the Commissioner of Insurance sought to liquidate NBAT and sought to have NBA and NBAT declared one entity so that she could also liquidate NBA. In its May 10, 1995 Order, the Franklin Circuit Court found that NBA and NBAT were one entity based on NBA and NBAT's failure to observe any formalities of separate corporate existences:

> The administration agreement provided that NBA had complete and exclusive authority to market NBAT coverage, to set the premiums for NBAT coverage, to collect premiums for NBAT coverage, to receive claims under NBAT coverage, to adjust claims under NBAT coverage, to settle claims under NBAT coverage, to execute documents in the name of NBAT, to receive service of legal process on behalf of NBAT as designated agent, and to otherwise transact the business of NBAT. The unrefuted record shows that NBA had sole control of management of NBAT. NBAT had no offices or operations other than those provided by NBA. NBAT had no employees or officers other than its Executive Director whose sole source of compensation for his activities as Executive Director of NBAT came from NBA under the terms of the administration agreement. Only officers or employees of NBA could sign checks on NBAT's bank accounts. Thus, NBAT acted through and as one with NBA.

(E.R. 120 at 122-23). Thus, the state court placed NBA into liquidation under the terms of its earlier

order directing the liquidation of NBAT as an insolvent, unauthorized insurer. *Id.* at 125.

Applying the law of issue preclusion or collateral estoppel – applicable in dischargeability proceedings – the Ninth Circuit held as a matter of law that NBAT and NBA were one entity, and therefore, as a matter of law, there was an express trust. *Clark v. Glogower*, No. 07-16188, 2009 WL 887959, 812 (9th Cir. Apr. 03, 2009). The Full Faith and Credit Clause of the United States Constitution provides that states must give full faith and credit to the judicial proceedings of other states. U.S. CONST. ART. IV, § 1. Congress sets forth the manner in which such full faith and credit is to be given in 28 U.S.C. § 1738, declaring that "[t]he . . . judicial proceedings of any court of any . . . State, Territory or Possession . . . shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken."

The Supreme Court has followed this command when the issue has arisen before it, explaining that:

> [T]hough the federal courts may look to the common law or to the policies supporting res judicata and collateral estoppel in assessing the preclusive effect of decisions of other federal courts, Congress has specifically required all federal courts to give preclusive effect to state-court judgments whenever the

> courts of the State from which the judgments emerged would do so.

Allen v. McCurry, 449 U.S. 90, 96 (1980). *See also Kremer v. Chem. Constr. Corp.*, 456 U.S. 461 (1982); *Parsons Steel, Inc. v. First Alabama Bank*, 474 U.S. 518 (1986); *Migra v. Warren City School Dist. Bd. of Educ.*, 465 U.S. 75 (1984). As made clear by the Supreme Court, "res judicata and collateral estoppel not only reduce unnecessary litigation and foster reliance on adjudication, but also promote the comity between state and federal courts that has been recognized as a bulwark of the federal system." *Allen v. McCurry*, 449 U.S. at 95-96.

Bankruptcy dischargeability proceedings are not exempted from the application of collateral estoppel principles. *See Grogan v. Garner*, 498 U.S. 279. Recognizing the preclusive effect of a state court determination on one or more elements of a non-dischargeability claim, therefore, does not elevate state law over federal bankruptcy law. *Id.* In *Grogan*, creditors who had obtained a money judgment in state court on the grounds that the debtor had defrauded them, sought to have the debt ruled non-dischargeable after the debtor filed bankruptcy. The bankruptcy court ruled that, as all of the elements required to establish actual fraud under 11 U.S.C. § 523 had been proved in state court, the doctrine of collateral estoppel required a holding that the debt was not dischargeable. This Court affirmed the bankruptcy court's application of collateral estoppel, stating "[o]ur prior cases have suggested, but have not

formally held, that the principles of collateral estoppel apply in bankruptcy proceedings under the current Bankruptcy Act. . . . We now clarify that collateral estoppel principles do indeed apply in discharge exception proceedings pursuant to § 523(a)." *Id.* at 284 n.11. The Court held the standard of proof to apply to the discharge exceptions of § 523 is the preponderance of the evidence standard. *Id.* at 291. Thus, if a creditor has already proved an element of non-dischargeability in state court in his or her state claim, then collateral estoppel will apply to prevent the debtor from relitigating that element in the dischargeability proceedings. *Id.* at 284.

B. Kentucky Collateral Estoppel Law Dictates that the Franklin Circuit Court's May 1995 Order be Given Preclusive Effect.

The Ninth Circuit Court of Appeals was compelled to give collateral estoppel effect to the May 1995 Franklin Circuit Court Order to the same extent that the Kentucky courts would have done so. *Allen*, 449 U.S. at 96; *Grogan*, 498 U.S. at 284 n.11. Under the applicable Kentucky law of collateral estoppel, the order would have had preclusive effect.

In Kentucky, the elements required for issue preclusion are: (i) identity of issues; (ii) actual litigation of the issue in the first case; (iii) a decision on the issue in the first case; and (iv) the necessity of the decision on the issue in the first case on the court's

judgment. *Yeoman v. Commonwealth*, 983 S.W.2d 459, 465 (Ky. 1998). *See also Sedley v. City of West Buechel*, 461 S.W.2d 556 (Ky. 1971) (adopting concept of issue preclusion). The rule that issues that have already been litigated cannot be the subject matter of a later action "is not only salutary, but necessary to the speedy and efficient administration of justice." *Yeoman*, 983 S.W.2d at 465.

All of the requirements for the application of collateral estoppel under Kentucky law are met by the May 1995 Order of the Franklin Circuit Court. First, the issue in the state court proceeding, whether NBA was an entity separate from the trust, was identical to the issue in the bankruptcy dischargeability proceeding. Second and third, there was actual litigation of the single entity issue in the Franklin Circuit Court and a final decision on the merits. The issue was briefed extensively by the parties and was ripe for a decision. (E.R. 120). The Franklin Circuit Court entered its order granting summary judgment to the then-Commissioner of the Kentucky Department of Insurance, acting in her capacity as Liquidator, on May 10, 1995. Moreover, it is uncontested that the May 10, 1995 Order was a final decision on the merits.

Finally, the issue of whether NBAT and NBA were one and the same entity was necessary to the state court's judgment. The Commissioner brought her original Complaint under KRS § 304.33-190, which allows her to petition the court for an order directing her to liquidate a domestic insurer on any

ground specified in KRS § 304.33-140 "whenever [s]he believes that attempts to rehabilitate the insurer would substantially increase the risk of loss to its creditors, its policyholders or the public, or would be futile, or that rehabilitators would serve no useful purpose." The grounds in KRS § 304.33-140 upon which the Commissioner sought liquidation were:

> (b) That [she] has reasonable cause to believe that there has been . . . wrongful sequestration or diversion of the insurer's assets . . . that if established would endanger assets in an amount threatening the solvency of the insurer[;]
>
> (d) That the insurer is or is about to become insolvent[; and]
>
> (f) That the insurer is in such condition that the further transaction of business would be hazardous, financially or otherwise, to its policyholders, its creditors, or the public.

A plain reading of the statutes shows that it was necessary for the court to find that NBAT and NBA were one and the same – an unauthorized insurer – for the Commissioner to have the authority to liquidate NBA with NBAT. Otherwise, pursuant to KRS §§ 304.33-140 and 304.33-190, she would have only had the authority to liquidate NBAT. After deciding that NBAT and NBA were, in fact, one entity, the Franklin Circuit Court granted summary judgment to the Commissioner and ordered, "pursuant to KRS Chapter 304.33 that NBA be placed into liquidation under

the terms of the June 20, 1991 Order Directing Liquidation of National Business Association Trust." (E.R. 120 at 125).

C. Express Federal Policy of Deference to State Insurance Regulation Requires that Full Faith and Credit be Given to the Franklin Circuit Court's May 1995 Order.

In addition to the generally applicable law of preclusion and full faith and credit discussed above, the specific and express federal policy of deferring to the states in the sphere of insurance regulation provides further reason to give preclusive effect to the decisions of state courts in insurance liquidation matters. The McCarran-Ferguson Act provides that states may create laws regulating the insurance business. The Act creates a presumption against federal preemption of state insurance laws, providing that federal laws will not supersede state insurance law unless the federal law "specifically relates to the business of insurance." 15 U.S.C. § 1012.

The Bankruptcy Code, 11 U.S.C. § 109(b)(2), moreover, states that a domestic insurance company may not be a debtor under Chapter 7. Therefore, federal bankruptcy law does not supersede Kentucky insurance regulations. Rather, federal bankruptcy law, by excluding insurers from the purview of the Bankruptcy Code, specifically embraces a policy of deferring to the states in the handling of insurance

liquidation matters. Thus, the fact that the Franklin Circuit Court's determination that NBAT and NBA were a single legal entity was made in the context of insurance liquidation proceedings, and related specifically to the determination of what assets were available in liquidation for the protection of policyholders, weighs particularly heavily in favor of the Ninth Circuit's decision to give that judgment full faith and credit.

Taken together, the McCarran-Ferguson Act and the insurance company exclusion from the Bankruptcy Code embody a strong federal policy of deferring to state regulation of the insurance industry. *Wolfson v. Mut. Benefit Life Ins. Co.*, 51 F.3d 141, 147 (8th Cir. 1995). Indeed, this federal policy:

> as reflected in the McCarran-Ferguson Act and the express exclusion of insurance companies from the federal Bankruptcy Code . . . symbolize[s] the public interest in having the States continue to serve their traditional role as the preeminent regulators of insurance in our federal system and indicates the special status of insurance in the realm of state sovereignty.

Munich Am. Reinsurance Co. v. Crawford, 141 F.3d 585, 595 (5th Cir. 1998).

KRS § 304.33-190 gives the Franklin Circuit Court regulatory authority over all insurance liquidation disputes. This ensures that a court with advanced knowledge of the nuances and intricacies of

the state insurance industry will make all liquidation decisions. Because the Franklin Circuit Court has the greatest knowledge of the industry in Kentucky, its ruling, that, as a matter of law, NBAT and NBA were one entity, should have been and was honored by the Ninth Circuit Court of Appeals.

Indeed, if the Ninth Circuit had not given full faith and credit to the Franklin Circuit Court's determination that NBAT and NBA were one entity, yet another loophole would exist to facilitate unauthorized insurance. Under current Kentucky law, the principals of an unauthorized insurer are directly liable for the insurer's unpaid claims and losses. *See* KRS § 304.11-030(3)(b). If federal bankruptcy courts do not respect state court judgments concerning the validity of entity arrangements like that between NBAT and NBA, those with control of the funds paid to unauthorized insurance companies would be free to siphon off as much as they wish so long as their company is structured in such a way as to place an intermediate step between the trust and themselves. The deterrent effect of KRS § 304.11-030(3)(b), creating liability for those who facilitate unauthorized insurance activities, would be completely vitiated. Moreover, it would further obstruct regulators' ongoing efforts to effectively regulate the insurance industry and would essentially permit "laundering" of funds, in which trustees shift fiduciary obligations to one legal entity while channeling profits from self-dealing to a separate legal entity under the control of the individual channeling the funds. *Nat'l Bus. Ass'n*

Trust v. Morgan, 770 F. Supp. 1169, 1177 (W.D. Ky. 1991). In essence, a decision to disregard the Franklin Circuit Court's holding of one entity, would provide a "road map" for future unauthorized insurers wishing to escape liability for their misdeeds. A fiduciary could continue to market an insurance trust he knows to be insolvent and to accept new policyholders (even though the trust cannot pay the claims of existing policyholders), by simply funneling "administrative fees" into a separate account – at the expense of the very policyholders to whom he owes his fiduciary duty – and will as a result be rewarded by the discharge of the debt he should be adjudged to owe when his house of cards finally collapses.

D. As NBAT/NBA was an Express Trust as a Matter of Law, the Petitioner's Liability to the Liquidator for the Bonus Payment and Loan Payment is Non-Dischargeable Pursuant to 11 U.S.C. § 523(a)(4).

The Ninth Circuit after giving full faith and credit to the Franklin Circuit Court's holding that NBAT and NBA as one entity fulfilled the requirement for an express trust, held the remaining two elements for non-dischargeability under 11 U.S.C. § 523(a)(4): (1) Petitioner was a fiduciary of the express trust and (2) Petitioner misappropriated or failed to account for the trust funds; were also satisfied. *Clark v. Glogower*, No. 07-16188, 2009 WL 887959, 812 (9th Cir. Apr. 03, 2009).

1. The Petitioner Acted In A Fiduciary Capacity For The NBAT/NBA Express Trust.

While 11 U.S.C. § 523(a)(4) discharges a debt for fraud or defalcation while acting in a fiduciary capacity, the Ninth Circuit has held that a broad, general definition of fiduciary – a relationship involving confidence, trust, and good faith – is inapplicable in the dischargeability context. *See Ragsdale v. Haller*, 780 F.2d 794, 796 (9th Cir. 1986). Rather, the Ninth Circuit has held the term "fiduciary" under 11 U.S.C. § 523(a)(4) only applies to express and technical trusts. *See In re Lewis*, 97 F.3d 1182, 1185 (9th Cir. 1996), *In re Johnson*, 691 F.2d 249, 251 (6th Cir. 1982). Accordingly, as its President and CEO, Glogower acted in a 11 U.S.C. § 523(a)(4) fiduciary capacity for the NBAT/NBA Express Trust over which he had general control and authority. (*See* E.R. 229; *see also* E.R. 1; E.R. 21 at 22; E.R. 25). Moreover, the Petitioner admitted to the Bankruptcy Court that as CEO and President he had complete authority over the plan administrator component of the NBAT/NBA Express Trust. (E.R. 195). Consequently, the Ninth Circuit upheld the Bankruptcy Court's determination that Petitioner was a fiduciary for purposes of 11 U.S.C. § 523(a)(4) and ERISA. *Clark v. Glogower*, No. 07-16188, 2009 WL 887959 (9th Cir. Apr. 03, 2009).

2. The Petitioner Breached His Fiduciary Duties Through His Failure To Properly Account For NBAT/NBA Funds.

As the President and CEO, Glogower had complete control and authority over the assets of the NBAT/NBA Express Trust. (E.R. 21 at 22). At a time when Glogower was aware that the NBAT/NBA Express Trust was insolvent by millions of dollars and that insureds' claims checks were being held, he continued to make payments to himself, continued to collect premium payments from insureds, and oversaw the continued marketing of the NBAT/NBA Express Trust to unsuspecting customers. Above and beyond these actions, the Petitioner continued to make payments from NBAT to the plan administrator (from which Glogower misappropriated funds for his own personal use).[3] When referring to Glogower's receipt of the unauthorized Loan and Bonus Payments, the Bankruptcy Court explicitly noted that:

> Glogower's actions were particularly egregious where NBA/NBAT was holding properly payable benefit checks due plan participants/employees because there were insufficient funds to allow such checks to be honored when presented. In perhaps the ultimate

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[3] In fact, the Debtor demonstrated his attitude of entitlement to use NBAT/NBA Express Trust funds as his own when he admitted at trial that his various corporate "loans" could: "have been for a mortgage payment. It could have been for washing the dog. It could have been for anything." (E.R. 225-26).

> defalcation in fiduciary capacity constituting an improper misappropriation of trust funds, Glogower decided to pay himself when he was fully aware that the entities (NBAT/NBA) he controlled could not pay the claims due the plan beneficiaries.

(E.R. 229 at 232).

Moreover, these payments were not secured through recognized corporate resolutions, but were instead fraudulently obtained to benefit the Petitioner at the expense of the NBAT/NBA Express Trust insureds. Additionally, the Petitioner breached his fiduciary duties by never informing policyholders of the NBAT/NBA Express Trust's insolvency or that claims checks were being held. In its March 24, 2004 Order, the Bankruptcy Court found that:

> Based upon all of the evidence before it, the court agrees that the defendant violated his fiduciary duty of disclosure when he failed to adequately inform the beneficiaries and their employers of the severe financial distress of the NBAT. The court has already concluded that the operations of NBAT "were a financial disaster in every sense of the word." For example, in April 1990, when operations ceased, NBAT released for payment claim checks totaling about $3.5 million, but had to hold claim checks totaling about $5.7 million because it lacked the funds to pay those legitimate claims.

Id. (E.R. 236).

Moreover, as an unauthorized insurer, the NBAT/NBA Express Trust did not comply with the various Kentucky statutory requirements designed to protect the interests of policyholders. (E.R. 113). The Petitioner, despite his fiduciary duty of care, never maintained the required level of reserves and consequently failed to safeguard the investment of the trust beneficiaries. Instead of notifying the NBAT trustees and beneficiaries of the financial distress of the Trust, the Petitioner continued to collect premium payments and direct the continued marketing of the Trust.

Therefore, the Ninth Circuit upheld the Bankruptcy Court's finding that the Petitioner acted in a fiduciary capacity for the NBAT/NBA Express Trust, and that Glogower's actions resulted in a direct loss to the NBAT/NBA Express Trust beneficiaries – monies that could have been utilized to pay policyholder claims that were instead siphoned to the plan administrator component of the Trust (from which the unauthorized Bonus and Loan Payments were secured by the Petitioner). Therefore, the last two elements of the test were satisfied for finding the debt non-dischargeable under 11 U.S.C. § 523(a)(4). *Clark v. Glogower*, No. 07-16188, 2009 WL 887959 (9th Cir. Apr. 03, 2009).

II. THE NINTH CIRCUIT CORRECTLY HELD THAT PETITIONER'S STATUS AS AN ERISA FIDUCIARY FULFILLED THE REQUIREMENTS OF A FIDUCIARY UNDER 11 U.S.C. § 523(A)(4).

Should it hear this case, this Court should take this matter as an opportunity to affirm the Ninth Circuit's precedents holding that a debtor's status as a fiduciary under ERISA satisfies the fiduciary duty element of 11 U.S.C. § 523(a)(4). This is an issue of first impression for the Court, and a definitive ruling from this Court on the question would provide valuable guidance to the lower federal courts in applying § 523(a)(4).

The Ninth Circuit affirmed the Bankruptcy Court's determination that Petitioner was an ERISA fiduciary, and therefore, a fiduciary under 11 U.S.C. § 523(a)(4). *Clark v. Glogower*, No. 07-16188, 2009 WL 887959 (9th Cir. Apr. 03, 2009). The Ninth Circuit based its holding on its own case of *In re Hemmeter*, which squarely addressed the question of whether ERISA fiduciaries also constitute fiduciaries under 11 U.S.C. § 523(a)(4). *In re Hemmeter*, 242 F.3d 1186, 1190 (9th Cir. 2001). In that case, the Ninth Circuit reiterated the "fiduciary" requirements outlined in 29 U.S.C. § 1002(21)(A) and held that "these [fiduciary] duties necessarily arise upon creation of an ERISA plan and predate the creation of any debt to the plan participant creditor." *Id.* Critically, the Court stated that "[t]he trust res is identified by the creation of the plan itself." *Id.* Accordingly, as ERISA imposes

obligations on the fiduciary prior to the alleged wrongdoing, the Court found ERISA satisfied the traditional requirements for a statutory fiduciary to qualify as a fiduciary under 11 U.S.C. § 523(a)(4). *Id.*, (citing *Morgan v. Musgrove (In re)*, 187 B.R. 808, 814 (Bankr. N.D. Ga. 1995)).

This Court should affirm the Ninth Circuit's stance. ERISA expressly provides that "a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plant or exercises any authority or control respecting management or disposition of its assets. . . ." 29 U.S.C. § 1002(21)(A). This provision expresses an important federal policy imposing strict duties on persons such as Glogower to administer ERISA benefit plan funds in the best interest of the plan beneficiaries. As the Ninth Circuit has properly recognized, these are precisely the kind of duties that are intended to be non-dischargeable under § 523(a)(4).

In *Nat'l Bus. Assoc. Trust v. Morgan*, 770 F. Supp. 1169, 1171, 1175 (W.D. Ky. 1991), the Petitioner admitted NBAT was an ERISA plan. *Id.* The Petitioner admitted to the Bankruptcy Court that as CEO and President he had complete authority over the plan administrator component of the NBAT/NBA Express Trust. (E.R. 195).[4] Individuals are accorded fiduciary

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[4] Additionally, Mr. Dale Belt, the former Chief Financial Officer, testified before the Bankruptcy Court as the Appellee's

(Continued on following page)

status where they "personally and actively controlled and dominated a corporation involved in investing and managing plan funds." *Greenblatt v. Prescription Plan Services Corp.*, 783 F. Supp. 814, 821 (S.D.N.Y. 1992) (*quoting Lowen v. Tower Asset Mgmt., Inc.*, 829 F.2d 1209, 1220 (2nd Cir. 1987)). As President and CEO of the plan administrator component of the express trust, the Petitioner personally and actively controlled and dominated the investment and management of plan funds, and consequently stood in a fiduciary capacity to the NBAT/NBA Express Trust under ERISA.

The Petitioner was plainly on notice that he had special fiduciary duties with respect to the funds of NBAT. The Ninth Circuit correctly held that these fiduciary duties are the same as those intended to be protected by 11 U.S.C. § 523(a)(4). A clear ruling from this Court affirming that vitally important principle would advance the policy goals of both ERISA's fiduciary duty provisions and the fiduciary defalcation exception of § 523(a)(4).

CONCLUSION

One of the fundamental policies of bankruptcy law is to give a fresh start to the "honest but unfortunate

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complete authority and dominance over the plan administrator and confirmed that whenever Glogower requested funds, a check was cut. (E.R. 204).

debtor." *Grogan v. Garner*, 498 U.S. 279, at 286. In the matter at hand, however, the Petitioner is not "honest but unfortunate," but was an unauthorized health insurer, who through the creation of NBA's "administrative fee" attempted to escape his fiduciary duties to the policyholders. As policyholders' medical bills continued to pile up, Glogower held their checks, while simultaneously paying himself and hunting for more unsuspecting customers. Glogower violated his position of trust and clear fiduciary obligations, by continuing to enrich himself at the expense of the NBAT/NBA insureds. A reversal of the Ninth Circuit Court of Appeals' decision would serve as a blueprint for con artists to swindle innocent citizens seeking health insurance coverage. For the reasons stated above, Respondent respectfully requests this Court to reaffirm the principles of collateral estoppel and the Full Faith and Credit clause and their proper application in conjunction with bankruptcy law, and to resolve an issue of first impression, whether an ERISA fiduciary fulfills the requirements of a fiduciary under 11 U.S.C. § 523(a)(4).

Respectfully submitted,

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APPENDIX A

11 U.S.C. § 109: Who may be a debtor

(a) Notwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title.

(b) A person may be a debtor under chapter 7 of this title only if such person is not –

(1) a railroad;

(2) a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, a New Markets Venture Capital company as defined in section 351 of the Small Business Investment Act of 1958, a small business investment company licensed by the Small Business Administration under section 301 of the Small Business Investment Act of 1958, credit union, or industrial bank or similar institution which is an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act, except that an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor if a petition is filed at the direction of the Board of Governors of the Federal Reserve System; or

(3)

(A) a foreign insurance company, engaged in such business in the United States; or

(B) a foreign bank, savings bank, cooperative bank, savings and loan association, building and loan association, or credit union, that has a branch or agency (as defined in section 1(b) of the International Banking Act of 1978 in the United States.

(C) An entity may be a debtor under chapter 9 of this title if and only if such entity –

(1) is a municipality;

(2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter;

(3) is insolvent;

(4) desires to effect a plan to adjust such debts, and

(5)

(A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of

each class that such entity intends to impair under a plan in a case under such chapter;

(C) is unable to negotiate with creditors because such negotiation is impracticable; or

(D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.

(d) Only a railroad, a person that may be a debtor under chapter 7 of this title (except a stockbroker or a commodity broker), and an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor under chapter 11 of this title.

(e) Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than $250,000 and noncontingent, liquidated, secured debts of less than $750,000, or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than $250,000 and noncontingent, liquidated, secured debts of less than $750,000 may be a debtor under chapter 13 of this title

(f) Only a family farmer or family fisherman with regular annual income may be a debtor under chapter 12 of this title.

(g) Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if –

(1) the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case; or

(2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

(h)

(1) Subject to paragraphs (2) and (3), and notwithstanding any other provision of this section, an individual may not be a debtor under this title unless such individual has, during the 180-day period preceding the date of filing of the petition by such individual, received from an approved nonprofit budget and credit counseling agency described in section 111 (a) an individual or group briefing (including a briefing conducted by telephone or on the Internet) that outlined the opportunities for available credit counseling and assisted such individual in performing a related budget analysis.

(2)

(A) Paragraph (1) shall not apply with respect to a debtor who resides in a district for which the United States trustee (or the bankruptcy administrator, if any) determines that the approved nonprofit budget and credit counseling agencies for such district are not reasonably able to provide adequate services to the additional individuals who would otherwise seek credit counseling from such agencies by reason of the requirements of paragraph (1).

(B) The United States trustee (or the bankruptcy administrator, if any) who makes a determination described in subparagraph (A) shall review such determination not later than 1 year after the date of such determination, and not less frequently than annually thereafter. Notwithstanding the preceding sentence, a nonprofit budget and credit counseling agency may be disapproved by the United States trustee (or the bankruptcy administrator, if any) at any time.

(3)

(A) Subject to subparagraph (B), the requirements of paragraph (1) shall not apply with respect to a debtor who submits to the court a certification that –

(i) describes exigent circumstances that merit a waiver of the requirements of paragraph (1);

(ii) states that the debtor requested credit counseling services from an approved nonprofit budget and credit counseling agency, but was unable to

obtain the services referred to in paragraph (1) during the 5-day period beginning on the date on which the debtor made that request; and

(iii) is satisfactory to the court.

(B) With respect to a debtor, an exemption under subparagraph (A) shall cease to apply to that debtor on the date on which the debtor meets the requirements of paragraph (1), but in no case may the exemption apply to that debtor after the date that is 30 days after the debtor files a petition, except that the court, for cause, may order an additional 15 days.

(4) The requirements of paragraph (1) shall not apply with respect to a debtor whom the court determines, after notice and hearing, is unable to complete those requirements because of incapacity, disability, or active military duty in a military combat zone. For the purposes of this paragraph, incapacity means that the debtor is impaired by reason of mental illness or mental deficiency so that he is incapable of realizing and making rational decisions with respect to his financial responsibilities; and "disability" means that the debtor is so physically impaired as to be unable, after reasonable effort, to participate in an in person, telephone, or Internet briefing required under paragraph (1).

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15 U.S.C. § 1012

(a) State regulation

The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) Federal regulation

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended [15 U.S.C. 41 et seq.], shall be applicable to the business of insurance to the extent that such business is not regulated by State Law.

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28 U.S.C. § 1738: State and Territorial statutes and judicial proceedings; full faith and credit

The Acts of the legislature of any State, Territory, or

Possession of the United States, or copies thereof, shall be authenticated by affixing the seal of such State, Territory or Possession thereto.

The records and judicial proceedings of any court of any such State, Territory or Possession, or copies thereof, shall be proved or admitted in other courts within the United States and its Territories and Possessions by the attestation of the clerk and seal of the court annexed, if a seal exists, together with a certificate of a judge of the court that the said attestation is in proper form.

Such Acts, records and judicial proceedings or copies thereof, so authenticated, shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken.

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29 U.S.C. § 1002(21)

(A) Except as otherwise provided in subparagraph (B), a person is a fiduciary with respect to a plan to the extent

(i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets,

(ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or

(iii) he has any discretionary authority or discretionary responsibility in the administration of such plan. Such term includes any person designated under section 1105(c)(1)(B) of this title.

(B) If any money or other property of an employee benefit plan is invested in securities issued by an investment company registered under the Investment Company Act of 1940 [15 U.S.C. 80a-1 et seq.], such investment shall not by itself cause such investment company or such investment company's investment adviser or principal underwriter to be deemed to be a fiduciary or a party in interest as those terms are defined in this subchapter, except insofar as such investment company or its investment adviser or principal underwriter acts in connection with an employee benefit plan covering employees of the investment company, the investment adviser, or its principal underwriter. Nothing contained in this subparagraph shall limit the duties imposed on such investment company, investment adviser, or principal underwriter by any other law.

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29 U.S.C. § 1104(a) Prudent man standard of care

(1) Subject to sections 1103(c) and (d), 1342, and 1344 of this title, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and

(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; and

(ii) defraying reasonable expenses of administering the plan;

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III of this chapter.

KRS § 304.11-030: Prohibition of unauthorized insurance business; applicability of law; liability of person acting as agent; executive director's power to enjoin

(1) It shall be unlawful for any company to enter into a contract of insurance as an insurer or to transact insurance business in this state, as set forth in subsection (2) of this section without a certificate of authority from the executive director; provided, that this subsection shall not apply to:

(a) The lawful transaction of surplus lines insurance.

(b) The lawful transaction of reinsurance by insurers.

(c) Transactions in this state involving a policy lawfully solicited, written, and delivered outside of this state covering only subjects of insurance not resident, located, or expressly to be performed in this state at the time of issuance, and which transactions are subsequent to the issuance of such policy.

(d) Transactions involving contracts of insurance independently procured through negotiations occurring entirely outside of this state which are reported and on which premium tax is paid.

(e) Attorneys acting in the ordinary relation of attorney and client in the adjustment of claims or losses.

(f) Transactions in this state involving group life and group health or blanket health insurance or group annuities where the master policy of such groups was lawfully issued and delivered in a state in which the company was authorized to do an insurance business.

(g) Transactions in this state involving any policy of insurance issued prior to July 1, 1968.

(h) Insurance on vessels, craft or hulls, cargoes, marine builder's risk, marine protection and indemnity or other risk, including strikes and war risks commonly insured under ocean or wet marine forms of policy.

(2) Any of the following acts in this state effected by mail or otherwise is defined to be doing an insurance business in this state. The venue of an act committed by mail is at the point where the matter transmitted by mail is delivered and takes effect. Unless otherwise indicated, the term "insurer" as used in this section includes all corporations, associations, partnerships and individuals, engaged as principals in the business of insurance and also includes interinsurance exchanges and mutual benefit societies.

(a) The making of or proposing to make, as an insurer, an insurance contract.

(b) The making of or proposing to make, as guarantor or surety, any contract of guaranty or suretyship as a vocation and not merely incidental to

any other legitimate business or activity of the guarantor or surety.

(c) The taking or receiving of any application for insurance.

(d) The receiving or collection of any premiums, commissions, membership fees, assessments, dues or other consideration for any insurance or any part thereof.

(e) The issuance or delivery of contracts of insurance to residents of this state or to persons authorized to do business in this state.

(f) Directly or indirectly acting as an agent for, or otherwise representing or aiding on behalf of another, any person or insurer in the solicitation, negotiation, procurement or effectuation of insurance or renewals thereof or in the dissemination of information as to coverage or rates, or forwarding of applications, or delivery of policies or contracts, or inspection of risks, or fixing of rates or investigation or adjustment of claims or losses, or in the transaction of matters subsequent to effectuation of the contract and arising out of it, or in any other manner representing or assisting a person or insurer in the transaction of insurance with respect to subjects of insurance resident, located or to be performed in this state. The provisions of this subsection shall not operate to prohibit full-time salaried employees of a corporate insured from acting in the capacity of an insurance manager or buyer in placing insurance in behalf of such employer.

(g) The doing of any kind of insurance business specifically recognized as constituting the doing of an insurance business within the meaning of the statutes relating to insurance.

(h) The doing or proposing to do any insurance business in substance equivalent to any of the foregoing in a manner designed to evade the provisions of this code.

(i) Any other transactions of business in this state by an insurer.

(3)

(a) The failure of a company transacting insurance business in Kentucky to obtain a certificate of authority shall not impair the validity of any act or contract of such company and shall not prevent such company from defending any action at law or suit in equity in any court of this state.

(b) In event of failure of any such unauthorized insurer to pay any claim or loss within the provisions of such insurance contract, any person who assisted or in any manner aided directly or indirectly in the procurement of such insurance contract shall be liable to the insured for the full amount of the claim or loss in the manner provided by the provisions of such insurance contract.

(4) Whenever the executive director believes, from evidence satisfactory to him, that any company is violating or about to violate the provisions of these sections, the executive director may, through the

Attorney General of this state, cause a complaint to be filed in the Circuit Court of Franklin County to enjoin and restrain such company from continuing such violation or engaging therein or doing any act in furtherance thereof. The court shall have jurisdiction of the proceeding and shall have the power to make and enter an order or judgment awarding such preliminary or final injunctive relief as in its judgment is proper.

KRS § 304.33-010: Title, construction, and purpose

(1) Short title. This subtitle may be cited as the "Insurers Rehabilitation and Liquidation Law."

(2) Construction. No limitation of powers. This subtitle shall not be interpreted to limit the powers granted the executive director by other provisions of the law.

(3) Liberal construction. This subtitle shall be liberally construed to effect the purpose stated in subsection (4) of this section.

(4) Purpose. The purpose of this subtitle is the protection of the interests of insureds, creditors, and the public generally, with minimum interference with the normal prerogative of proprietors, through:

(a) Early detection of any potentially dangerous condition in an insurer, and prompt application of appropriate corrective measures, neither unduly

harsh nor subject to the kind of publicity that would needlessly damage or destroy the insurer;

(b) Improved methods for rehabilitating insurers, by enlisting the advice and management expertise of the insurance industry;

(c) Enhanced efficiency and economy of liquidation, through the consolidation of matters relating to the liquidation under the supervision of a single court so as to avoid divergent rulings by a multiplicity of judicial tribunals and through clarification and specification of the law, to minimize legal uncertainty and litigation;

(d) Equitable apportionment of any unavoidable loss;

(e) Lessening the problems of interstate rehabilitation and liquidation by facilitating cooperation between states in the liquidation process, and by extension of the scope of personal jurisdiction over debtors of the insurer outside this state;

(f) Regulation of the insurance business by the impact of the law relating to delinquency procedures and substantive rules on the entire insurance business; and

(g) Provision for a comprehensive scheme for the supervision, rehabilitation, and liquidation of insurance companies and those subject to this subtitle as part of the regulation of the business of insurance, insurance industry, and insurers in this state. Proceedings in cases of insurer insolvency and delinquency

shall be deemed an integral aspect of the business of insurance and are of vital public interest and concern.

(5) All persons who voluntarily transact business with an insurer which is subsequently the subject of a delinquency proceeding under this subtitle shall be conclusively presumed to have transacted business with the intent that the provisions of this subtitle would control if there is any delinquency proceeding in this state.

(6) If there is a delinquency proceeding under this subtitle, the provisions of this subtitle shall govern those proceedings, and all conflicting contractual provisions contained in any contract between the insurer which is subject to the delinquency proceeding and any third party shall be deemed subordinated to the provisions of this subtitle. However, notwithstanding the foregoing, in any delinquency proceeding commenced against an insurer after July 15, 1996, nothing in this subtitle shall be construed to subordinate or restrict the rights of parties to submit their disputes to arbitration pursuant to a contractual arbitration clause contained in a reinsurance agreement.

KRS § 304.33-140: Grounds for rehabilitation

(1) The executive director may apply by verified petition to the court for an order directing him to rehabilitate a domestic insurer or an alien insurer

domiciled in this state on any one (1) or more of the following grounds:

(a) Any ground on which he may apply for an order of liquidation under KRS 304.33-190, whenever he believes that the insurer may be successfully rehabilitated without substantial increase in the risk of loss to creditors of the insurer or to the public.

(b) That the executive director has reasonable cause to believe that there has been embezzlement from the insurer, wrongful sequestration or diversion of the insurer's assets, forgery or fraud affecting the insurer, or other illegal conduct in, by, or with respect to the insurer, that if established would endanger assets in an amount threatening the solvency of the insurer.

(c) That any one (1) of the following circumstances has occurred and the executive director has reasonable cause to believe that the insurer is insolvent or that assets are endangered in an amount threatening the solvency of the insurer:

1. That information coming into the executive director's possession has disclosed substantial and not adequately explained discrepancies between the insurer's records and the most recent annual report or other official company reports;

2. That the insurer has failed to remove any person who in fact has executive authority in the insurer, whether an officer, manager, general agent, employee, or other person, if the person has been found by the executive director after notice and hearing to be

dishonest or untrustworthy in a way affecting the insurer's business;

3. That control of the insurer, whether by stock ownership or otherwise, and whether direct or indirect, is in one (1) or more persons found by the executive director after notice and hearing to be dishonest or untrustworthy;

4. That any person who in fact has executive authority in the insurer, whether an officer, manager, general agent, employee, or other person, has refused to be examined under oath by the executive director concerning its affairs, whether in this state or elsewhere, and after reasonable notice of the fact the insurer has failed promptly and effectively to terminate the employment and status of the person and all his influence on management;

5. That the insurer has refused to submit its books, accounts, documents, or other records to the reasonable examination or inspection of the executive director or his authorized representative.

(d) That the insurer is or is about to become insolvent.

(e) That the insurer is engaging in a systematic practice of reaching settlements with and obtaining releases from policyholders or third-party claimants and then unreasonably delaying payment of or failing to pay the agreed upon settlements.

(f) That the insurer is in such condition that the further transaction of business would be hazardous,

financially or otherwise, to its policyholders, its creditors, or the public.

(g) That within the previous twelve (12) months the insurer has systematically attempted to compromise with its creditors on the ground that it is financially unable to pay its claims in full.

(h) That without first obtaining the written consent of the executive director, the insurer has transferred, or attempted to transfer, substantially its entire property or business, or has entered into any transaction the effect of which is to merge, consolidate, or reinsure substantially its entire property or business in or with the property or business of any other person.

(i) That the insurer or its property has been or is the subject of an application for the appointment of a receiver, trustee, custodian, conservator, or sequestrator or similar fiduciary of the insurer or its property otherwise than as authorized under this subtitle, and that such appointment has been made or is imminent, and that such appointment might oust the courts of this state of jurisdiction or prejudice orderly delinquency proceedings under this subtitle.

(j) That within the previous year the insurer has willfully violated its charter or articles of incorporation or any insurance law or regulation of this state, or having become aware within the previous year of an unintentional violation has failed to take

all reasonable steps to remedy the situation resulting from the violation and to prevent future violations.

(k) That the directors of the insurer are deadlocked in the management of the insurer's affairs and that the members or shareholders are unable to break the deadlock and that irreparable injury to the insurer, its creditors or its policyholders is threatened by reason thereof.

(l) That the insurer has failed to file its annual report or other report within the time allowed by law, and after written demand by the executive director has failed to give an adequate explanation immediately.

(m) That two-thirds (⅔) of the board of directors, or the holders of a majority of the shares entitled to vote, or a majority of members or policyholders of an insurer subject to control by its members or policyholders, consent to rehabilitation under this subtitle.

(2) Upon the issuance of an order directing the executive director to rehabilitate a domestic insurer, the court shall have exclusive jurisdiction over all matters relating to the rehabilitation, including, but not limited to, the proper scope and application of the provisions of this subtitle to the rehabilitation as well as all interpretation and enforceability of all contracts of insurance to which the insurer is a party.

KRS § 304.33-190: Grounds for liquidation

(1) The executive director may apply by petition to the Circuit Court for Franklin County or for the county in which the principal office of the insurer is located for an order directing him to liquidate a domestic insurer or an alien insurer domiciled in this state on any one (1) or more of the following grounds:

(a) Any ground on which he may apply for an order of rehabilitation under KRS 304.33-140, whenever he believes that attempts to rehabilitate the insurer would substantially increase the risk of loss to its creditors, its policyholders or the public, or would be futile, or that rehabilitators would serve no useful purpose;

(b) That the insurer has commenced, or within the previous year has attempted to commence, voluntary liquidation otherwise than under the insurance laws of this state;

(c) That the holders of two-thirds (⅔) of the shares entitled to vote, or two-thirds (⅔) of the members or policyholders entitled to vote in an insurer controlled by its members or policyholders, have consented to a petition.

(2) Upon the issuance of an order directing the executive director to liquidate a domestic insurer, the court shall have exclusive jurisdiction over all matters relating to the liquidation, including, but not limited to, the proper scope and application of the provisions of this subtitle to the liquidation as well as

all interpretation and enforceability of all contracts of insurance to which the insurer is a party.

KRS § 304.33-240: Powers of liquidator

The liquidator shall report to the court monthly, or at other intervals specified by the court, on the progress of the liquidation in whatever detail the court orders. The liquidator may:

(1) Appoint a special deputy to act for him under this subtitle, and, subject to the court's approval, determine his compensation. The special deputy shall have all powers of the liquidator granted by this section. The special deputy shall serve at the pleasure of the liquidator.

(2) Appoint or engage employees and agents, legal counsel, actuaries, accountants, appraisers, consultants, and other personnel he deems necessary to assist in the liquidation.

(3) Fix the compensation of persons under subsection (2) of this section, subject to the control of the court.

(4) Defray all expenses of taking possession of, conserving, conducting, liquidating, disposing of or otherwise dealing with the business and property of the insurer. If the property of the insurer does not contain sufficient cash or liquid assets to defray the costs incurred, the liquidator may advance the costs so incurred out of any available appropriation. Any

amounts so paid shall be deemed expense of administration and shall be repaid for the credit of the Office of Insurance out of the first available moneys of the insurer.

(5) Hold hearings, subpoena witnesses and compel their attendance, administer oaths, examine any person under oath, and compel any person to subscribe to his testimony after it has been correctly reduced to writing, and in connection therewith require the production of any books, papers, record, or other documents which he deems relevant to the inquiry.

(6) Collect all debts and moneys due and claims belonging to the insurer, wherever located, and for this purpose institute timely action in other jurisdictions to marshal the assets of the insurer; forestall garnishment and attachment proceedings against such debts; do such other acts as are necessary or expedient to collect, conserve or protect its assets or property, including sell, compound, compromise or assign for purposes of collection, subject to court approval and upon such terms and conditions as he deems best, any disputed claims; and pursue any creditor's remedies available to enforce his claims. In lieu of collecting funds representing unearned premium of a policyholder which are in the possession of the insurer's agent with respect to the kinds of direct insurance protected under KRS 304.36-030, the liquidator may authorize the use of such funds to replace the insurance coverage terminated pursuant to KRS 304.33-210, upon receipt from the agent of appropriate notice of such

replacement of the insurance coverage with an insurer within sixty (60) days after the date of the liquidation order.

(7) Audit the books and records of all agents of the insurer insofar as these records relate to the business activities of the insurer.

(8) Conduct public and private sales of the property of the insurer in a manner prescribed by the court.

(9) Use assets of the estate to transfer policy obligations to a solvent assuming insurer, if the transfer can be arranged without prejudice to applicable priorities under KRS 304.33-430.

(10) Acquire, hypothecate, encumber, lease, improve, sell, transfer, abandon, or otherwise dispose of or deal with any property of the insurer at its market value or upon such terms and conditions as are fair and reasonable, except that no transaction involving property the market value of which exceeds ten thousand dollars ($10,000) shall be concluded without express permission of the court. He also may execute, acknowledge, and deliver any deeds, assignments, releases, and other instruments necessary or proper to effectuate any sale of property or other transaction in connection with the liquidation. In cases where real property sold by the liquidator is located other than in the county where the liquidation is pending, the liquidator shall cause to be filed with the county clerk for the county in which the property is located a certified copy of the order appointing him.

(11) Borrow money, subject to court approval, on the security of the insurer's assets or without security and execute and deliver all documents necessary to that transaction for the purpose of facilitating the liquidation.

(12) Enter into such contracts as are necessary to carry out the order to liquidate, and affirm or disavow any contracts to which the insurer is a party.

(13) Continue to prosecute and institute in the name of the insurer or in his own name any suits and other legal proceedings, in this state or elsewhere, and abandon the prosecution of claims he deems unprofitable to pursue further. If the insurer is dissolved under KRS 304.33-220, he may apply to any court in this state or elsewhere for leave to substitute himself for the insurer as plaintiff.

(14) Prosecute any action which may exist in behalf of the creditors, members, policyholders, or shareholders of the insurer against any officer of the insurer, or any other person.

(15) Remove any records and property of the insurer to the offices of the executive director or to such other place as is convenient for the purposes of efficient and orderly execution of the liquidation.

(16) Deposit in one (1) or more banks in this state such sums as are required for meeting current administration expenses and dividend distributions.

(17) File any necessary documents for record in the office of any county clerk or record office in this state or elsewhere where property of the insurer is located.

(18) Assert all defenses available to the insurer as against third persons, including statutes of limitations, statutes of frauds, and the defense of usury. A waiver of any defense by the insurer after a petition for liquidation has been filed shall not bind the liquidator.

(19) Exercise and enforce all the rights, remedies and powers of any creditor, shareholder, policyholder, or member, including any power to avoid any transfer or lien that may be given by law and that is not included within KRS 304.33-290, inclusive.

(20) Intervene in any proceeding wherever instituted that might lead to the appointment of a receiver or trustee, and act as the receiver or trustee whenever the appointment is offered.

(21) Enter into agreements with any receiver or commissioner of any other state relating to the rehabilitation, liquidation, conservation, or dissolution of an insurer doing business in both states.

(22) Exercise all powers now held or hereafter conferred upon receivers by the laws of this state not inconsistent with this subtitle.

(23) The enumeration in this section of the powers and authority of the liquidator is not a limitation upon him, nor does it exclude his right to do such other acts not herein specifically enumerated or

otherwise provided for as are necessary or expedient for the accomplishment of or in aid of the purpose of liquidation.